

REPORT OF EXAMINATION  
OF THE  
SPRINGFIELD INSURANCE COMPANY  
  
AS OF  
DECEMBER 31, 2006

Participating State  
and Zone:

California

Filed March 19, 2008

## TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION.....	1
MANAGEMENT AND CONTROL: .....	2
Intercompany Agreements .....	4
Non-Affiliated Agreements .....	6
TERRITORY AND PLAN OF OPERATION .....	6
REINSURANCE: .....	8
Assumed.....	8
Ceded .....	8
ACCOUNTS AND RECORDS .....	9
FINANCIAL STATEMENTS: .....	10
Statement of Financial Condition as of December 31, 2006 .....	11
Underwriting and Investment Exhibit for the Year Ended December 31, 2006.....	12
Reconciliation of Surplus as Regards Policyholders from December 31, 2003 through December 31, 2006 .....	13
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	14
Losses and Loss Adjustment Expenses .....	14
Amounts Withheld or Retained by Company for Account of Others.....	14
SUMMARY OF COMMENTS AND RECOMMENDATIONS:.....	15
Current Report of Examination.....	15
Previous Report of Examination.....	15
ACKNOWLEDGMENT.....	16

Los Angeles, California  
February 8, 2008

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Kent Michie  
Secretary, Zone IV-Western  
Commissioner of Insurance  
Department of Insurance, State of Utah  
Salt Lake City, Utah

Honorable Steve Poizner  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

SPRINGFIELD INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 874 South Village Oaks Drive, Covina, California 91724.

SCOPE OF EXAMINATION

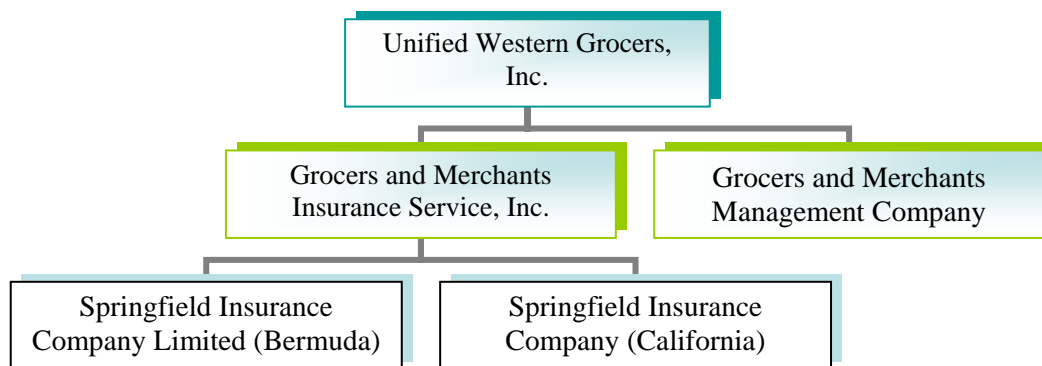
The previous examination of the Company was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2006. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

### MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Grocers and Merchants Insurance Service, Inc. (GMIS), which, in turn, is wholly-owned by Unified Western Grocers, Inc. (Unified). Unified is a non-insurance member-owned cooperative organization engaged primarily in the distribution of food products and related non-food items to retail establishments owned by member shareholders of the cooperative.

The following abridged organizational chart depicts the Company's relative position within the holding company system: (all ownership is 100%)



Management is vested in a seven-member board of directors elected annually. Following are lists of directors and principal officers of the Company as of December 31, 2006:

## Directors

### Name and Residence

### Principal Business Affiliation

Louis A. Amen  
Corona Del Mar, California

President  
Super A Foods, Inc.

Andrew J. Barile  
Rancho Santa Fe, California

President / Chief Executive Officer  
Andrew Barile Consulting Corporation, Inc.

David Bennett \*  
Hillsborough, California

Co-Owner  
Mollie Stone's Market

John Berberian  
Beverly Hills, California

President  
Berberian Enterprises, Inc.

Darioush Khaledi  
Palos Verdes Estates, California

Chairman and Chief Executive Officer  
K.V. Mart Company

Peter J. O'Neal  
Vancouver, Washington

President  
White Salmon Foods, Inc. & Estacada Foods, Inc.

Tom S. Sayles  
Los Angeles, California

President  
Rentech, Inc.

(\*) Resigned in March, 2006

## Principal Officers

### Name

### Title

Joseph A. Ney  
Jeffrey D. Moore  
Randall G. Scoville  
Richard J. Martin  
Robert M. Ling, Jr.  
Christine Neal  
Paula G. Spalding  
Jeffrey D. Haynes  
Louis E. Goldberg

President  
Vice President, Risk Management  
Chief Accounting Officer  
Chief Financial Officer  
Secretary  
Treasurer  
Vice President Underwriting  
Vice President, Workers Compensation Claims  
Vice President Property and Casualty Claims

## Intercompany Agreements

**Management Service Agreement:** Effective March 3, 1995, the Company entered into a Management Service Agreement with its parent, Grocers and Merchants Insurance Service, Inc. (GMIS), and its affiliate, Grocers and Merchants Management Company (GMMC). Under the terms of the agreement, GMIS and GMMC provides the Company with services including management, accounting, underwriting, claims, data processing, premium collection, commission accounting, and personnel services. The Company is charged the actual expenses incurred for the services provided.

**Brokerage Agreement:** GMIS also receives a commission ranging from 2% to 15% on business produced and serviced for the Company under the terms of a separate Brokerage Agreement dated March 3, 1995.

The Management Service Agreement and the Brokerage Agreement are renewable every three years. A new three-year agreement was renewed effective October 1, 2005. The California Department of Insurance (CDI) approved these agreements on February 28, 1995.

For 2004, 2005, and 2006, the Company paid \$7.1 million, \$7.0 million and \$7.3 million, respectively, to GMIS and GMMC for expenses and commissions incurred under the terms of these agreements.

**Service Agreement:** The Company extended its original Service Agreement dated January 1, 1997 with its ultimate parent, Unified Western Grocers, Inc. (Unified) for another three years effective January 1, 2005. Under the terms of the agreement, Unified provides the Company with services, such as human resources, payroll, internal audit function, procurement, and tax preparation. Unified provides the services to the Company at no cost.

Effective December 19, 2006, the Company terminated the above agreement and entered into a new Services Agreement with Unified. Under the terms of the new agreement, Unified provides the

Company administrative support services such as financial reporting, tax compliance, treasury services, budget and cost accounting, human resources, actuarial services and office services. The Company reimburses Unified for the actual cost of these services. The CDI approved this agreement on December 18, 2006. For 2006, the Company paid Unified \$862,801 under the terms of this agreement.

Lease Agreement: The Company leased a portion of its office space to its immediate parent, GMIS, under the terms of a lease agreement dated January 1, 1994. Subsequent to the examination date, on January 22, 2007, the Company and GMIS entered into a Purchase and Sale Agreement (Sale Agreement) wherein GMIS purchased the Company's home office building for \$3.2 million. Simultaneous with the Sale Agreement, the Company and GMIS entered into a Commercial Lease Agreement (Lease Agreement) wherein the Company now leases its home office building from GMIS. The Lease Agreement is effective February 1, 2007 for sixty months and the Company pays a minimum monthly rental of \$19,222. The CDI approved the Sale and Lease Agreements on May 7, 2007 pursuant to California Insurance Code Sections 1215.5(b)(1) and 1215.5(b)(4). The Sale and Lease Agreements were accounted for pursuant to the Statements of Statutory Accounting Principles (SSAP) 22, Paragraph 13.

Consolidated Federal Income Tax Agreement: The Company is a party to a Tax Allocation Agreement with its affiliates and Unified. Under the terms of this agreement, the companies file a consolidated federal income tax return. The consolidated federal income tax liability is allocated between the companies in the ratio that each company's separate tax return liability bears to the total consolidated federal income tax liability. This agreement was entered into and approved by the CDI on April 14, 1998. For 2004, 2005 and 2006 the Company paid \$670,000, \$2.0 million and \$1.1 million, respectively, in income tax to Unified under the terms of this agreement.

### Non-Affiliated Agreements

Investment Advisory Agreement: Effective October 1, 2001, the Company entered into an Investment Advisory Agreement with McDonnell Investment Management LLC (MIM). Under the terms of the agreement, MIM manages a portion of the Company's investment portfolio, subject to the investment policies and guidelines established by the Company. The investments managed under this agreement generally consist of fixed maturity, mortgage backed and U.S. Treasury investments. Compensation for these services is paid quarterly based on the fair market value of investments managed. The agreement is renegotiated every three years.

A Custody Agreement is in place with Union Bank of California, N.A. to serve as the custodian and depository for the Company's investments.

Security Investment Accounting Services Agreement: Effective March 31, 1996, the Company entered into a Security Investment Accounting Services Agreement with SunGard MIS, Inc. (SunGard). Under the terms of the agreement, SunGard provides the Company with a software system to process and report its stock, bond, and short-term investments in accordance with the reporting requirements of the National Association of Insurance Commissioners.

### TERRITORY AND PLAN OF OPERATION

As of December 31, 2006, the Company was licensed to transact business in Arizona, California, Nevada, Oregon, and Utah. In 2006, the Company wrote \$18.1 million of direct premiums. Of the direct premiums written, 92.4% or \$16.7 million was written in California, 6.9% or \$1.3 million was written in Oregon and the remaining .7% was written in Arizona and Nevada.

The Company provides workers' compensation, general liability and automobile liability coverage to the Company's ultimate parent, Unified Western Grocers, Inc. (Unified), and its subsidiaries. In



addition, workers' compensation, commercial automobile, general liability, and commercial package coverages are offered to Unified's member companies that are either wholesalers or retailers of grocery goods.

The Company's immediate parent, Grocers and Merchants Insurance Service, Inc. (GMIS), produces the majority of the Company's business, as well as operating as an insurance agency/broker for Unified and its member companies for other insurance coverages not offered by the Company.

In addition to the previously mentioned lines of business, the Company obtained a license in 2008 to transact marine, plate glass and boiler and machinery insurance products in California. The Company added the new lines of insurance to its existing commercial multiple peril package to provide a more comprehensive insurance program.

Effective January 1, 2007, the Company's corporate workers' compensation program was converted from a large deductible policy to a fully insured policy. As a result, the Company's earned premiums for this business increased approximately \$7.2 million in 2007.

## REINSURANCE

### Assumed

The Company does not assume reinsurance.

### Ceded

The following is a summary of the Company's principal reinsurance agreements in-force as of December 31, 2006:

Type of Contract and Lines of Coverage	Reinsurers' Name	Company's Retention	Reinsurers' Maximum Limits
<b><u>First Excess of Loss</u></b>			
Workers' Compensation (Coverage A)	Old Republic Insurance Company (*)	Coverage A: \$500,000	\$500,000
Employers' Liability (Coverage B)		Coverage B: \$500,000 BI by accident; \$500,000 BI by disease	\$500,000
<u>Corporate Program:</u>			
Commercial General Liabilities (Coverage C)		Coverage C: \$500,000 each loss occurrence	\$500,000 excess of first \$500,000
Commercial Auto Liability (Coverage D)		Coverage D: \$500,000 each loss occurrence	\$1.5 million excess of first \$500,000
<u>Member Package Program:</u>			
Commercial Package-General Liability (Coverage E)		Coverage E: \$500,000 for any one person	\$500,000 excess of first \$500,000
Commercial Auto Liability (Coverage F)		Coverage F: \$250,000 each accident combined for bodily injury and property damage	\$750,000 excess of first \$250,000

<b>Type of Contract and Lines of Coverage</b>	<b>Reinsurers' Name</b>	<b>Company's Retention</b>	<b>Reinsurers' Maximum Limits</b>
Commercial Package Property, including Crime and Inland Marine (Coverage G)		Coverage G: \$500,000 plus 80% of the \$500,000 excess of \$500,000 layer	20% of the \$500,000 excess of \$500,000 layer plus \$4 million excess of \$1 million
<b><u>Second Excess of Loss</u></b>			
	Old Republic Insurance Company		
Workers' Compensation (Coverage A)		\$ 1 million	\$59 million
Employers' Liability (Coverage B)		Coverage B: \$1 million BI by accident; \$1 million BI by disease	\$59 million

(\*) Effective June 1, 2005, a 100% retrocession agreement exists between Old Republic Insurance Company and the Company's affiliate, Springfield Insurance Company Ltd. (Bermuda) for the workers' compensation line of business. The retrocession agreement expired on May 31, 2007 and was not renewed, which effectively increased the Company's retention to \$1 million for the workers' compensation line of business.

The total reinsurance recoverable due the Company as of December 31, 2006, under the terms of its reinsurance agreements in force and in runoff was \$9.9 million.

### ACCOUNTS AND RECORDS

This examination experienced some delays in obtaining supporting documentation for various information reported in the Company's Annual Statement. This includes routine examination requests such as confirmation information, account reconciliations and detailed supporting records, schedules and reports. It is recommended that the Company provide supporting documentation for its financial statements in a timely manner to avoid unnecessary delays in performing future examinations. It should be noted that this recommendation has been made in previous examinations. The Company is also reminded that all of its books and records must be made available for examination pursuant to California Insurance Code Section 734. In response to this recommendation, the Company indicated that it anticipates adding additional staff in 2008 which will improve its ability to provide documentation on a timely basis.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Underwriting and Investment Exhibit for the Year Ended December 31, 2006

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2003 through December 31, 2006

Statement of Financial Condition  
as of December 31, 2006

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 55,178,853	\$	\$ 55,178,853	
Stocks:				
Preferred stocks	2,070,923		2,070,923	
Real Estate:				
Properties occupied by the company	1,660,148	480,259	1,179,889	
Cash, cash equivalents and short-term investments	2,836,844		2,836,844	
Investment income due and accrued	483,222		483,222	
Premiums and considerations:				
Uncollected premiums and agents' balances in course of collection	2,741,239		2,741,239	
Deferred premiums, agent's balances and installments booked but deferred and not yet due	4,245,981	51,495	4,194,486	
Accrued retrospective premiums	522,626	52,263	470,363	
Reinsurance:				
Amounts recoverable from reinsurers	270,525		270,525	
Other amounts receivable under reinsurance contracts	1,356,004		1,356,004	
Net deferred tax asset	2,058,170	1,108,520	949,650	
Aggregate write-ins for other than invested assets	<u>2,133,719</u>	<u>50,141</u>	<u>2,083,578</u>	
Total assets	<u>\$ 75,558,254</u>	<u>\$ 1,742,678</u>	<u>\$ 73,815,576</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 26,879,625	(1)
Loss adjustment expenses			6,791,451	(1)
Other expenses			310,882	
Current federal and foreign income taxes			1,160,912	
Unearned premiums			4,193,791	
Amounts withheld or retained by company for account of others			10,902,214	(2)
Payable to parent, subsidiaries and affiliates			538,840	
Aggregate write-ins for liabilities			<u>1,084,707</u>	
Total liabilities			51,862,422	
Common capital stock		\$ 2,600,000		
Gross paid-in and contributed surplus		8,900,000		
Unassigned funds (surplus)		<u>10,453,154</u>		
Surplus as regards policyholders			<u>21,953,154</u>	
Total liabilities, surplus and other funds			<u>\$ 73,815,576</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2006

Statement of Income

Underwriting Income

Premiums earned		\$ 15,430,146
Deductions:		
Losses incurred	\$ 2,281,900	
Loss expense incurred	4,765,052	
Other underwriting expenses incurred	<u>5,541,374</u>	
Total underwriting deductions		<u>12,588,326</u>
Net underwriting gain		2,841,820

Investment Income

Net investment income earned	\$ 2,232,540	
Net realized capital gains	<u>51,316</u>	
Net investment gain		2,283,856

Other Income

Aggregate write-ins for miscellaneous income	<u>\$ 89,778</u>	
Total other income		<u>89,778</u>
Net income before federal income taxes		5,215,454
Federal income taxes incurred		<u>1,091,173</u>
Net income		<u>\$ 4,124,281</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2005		\$ 19,172,604
Net income	\$ 4,124,281	
Change in net unrealized capital gains or (losses) less capital gains tax	(5,766)	
Change in net deferred income tax	(586,171)	
Change in nonadmitted assets	216,943	
Aggregate write-ins for gains and losses in surplus	<u>(968,737)</u>	
Change in surplus as regards policyholders		<u>2,780,550</u>
Surplus as regards policyholders, December 31, 2006		<u>\$ 21,953,154</u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2003 through December 31, 2006

Surplus as regards policyholders, December 31, 2003, per Examination \$ 11,433,235

	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>
Net income	\$ 10,584,961	\$
Net unrealized capital losses		22,027
Change in net deferred income tax	659,374	
Change in nonadmitted assets		837,713
Aggregate write-ins for gains and losses in surplus	<u>135,324</u>	<u></u>
Totals	<u>\$ 11,379,659</u>	<u>\$ 859,740</u>

Net change in surplus as regards policyholders for the examination period 10,519,919

Surplus as regards policyholders, December 31, 2006, per Examination \$ 21,953,154

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

The California Department of Insurance (CDI), pursuant to California Insurance Code (CIC) Section 733(g), retained an independent actuary for the purpose of providing a full actuarial evaluation of the Company's loss and loss adjustment expense reserves as of December 31, 2006. Based on the analysis by the independent actuary and a review of their work by a Casualty Actuary from the CDI, the Company's reserves for losses and loss adjustment expenses were determined to be reasonably stated.

Beginning in October 2001, the Company's corporate workers' compensation program was written with a \$100,000 deductible. From 2002 through 2006 the deductible was \$300,000. For the member program, large deductible policies ranging from \$100,000 to \$500,000 were offered beginning in 2002. The implementation of deductibles reduces the Company's net retention and shifts the Company's exposure from underwriting risk to credit risk.

As of December 31, 2006, \$12.4 million of loss and loss adjustment expense reserves were recorded for large deductibles on unpaid claims. Additionally, \$1.5 million of paid claims were billed and are recoverable and were reported in the aggregate write-ins for other than invested assets account.

### (2) Amounts Withheld or Retained by Company for Account of Others

The above captioned liability accounts consists entirely of cash and letters of credit held by the Company to cover future losses on high deductible policies.



## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records (Page 9): It is recommended that the Company provide supporting documentation for its financial statements, in a timely manner, to avoid delay in performing the examination. This recommendation has been made in the previous examination. The Company is also reminded that all of its books and records must be made available for examination pursuant to California Insurance Code Section 734. In response to this recommendation, the Company indicated that it anticipates adding additional staff in 2008 which will improve its ability to provide documentation on a timely basis.

### Previous Report of Examination

Summary of Significant Findings (Page 2): It was recommended that the Company immediately prepare a report to the Commissioner pursuant to the National Association of Insurance Commissioners' (NAIC) Risk-Based Capital (RBC) requirements. The Company complied with this recommendation.

Accounts and Records (Page 13): It was recommended that the Company maintain adequate documentation to support all information reported in its financial statements. The Company complied with this recommendation. It was also recommended that the Company follow Annual Statement instructions as well as California Insurance Code Section 11558 when completing future Annual Statements. The Company complied with this recommendation.

Losses and Loss Adjustment Expenses - Special Schedule P Deposit (Page 21): It was recommended that the Company recalculate its workers' compensation deposit requirements and immediately fund any deficiencies. The Company complied with this recommendation.

## ACKNOWLEDGMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Duane Armstrong, CFE  
Examiner-In-Charge  
Senior Insurance Examiner Supervisor  
Department of Insurance  
State of California